Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of: Inquiry Required By The Satellite Home Viewer Extension and Reauthorization Act On Rules Affecting Competition In The Television Marketplace	 MB Docket No. 05-28

REPLY COMMENTS OF VIACOM

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REPLY COMMENTS OF VIACOM

I. INTRODUCTION AND SUMMARY

Viacom hereby submits its Reply Comments in response to the FCC's Public Notice in the above-captioned proceeding. As it consistently has done in the past, the FCC should reject the calls of a small handful of commenters to intervene in the current, well-functioning retransmission consent system. EchoStar's recycled claim that the exchange of retransmission consent for carriage of affiliated program services should be banned as a violation of the antitrust law continues to be inconsistent with established Commission and judicial precedent. Moreover, there is no basis for the broad imposition of retransmission consent regulations that were crafted by the agency only to address the specific concerns raised by the *News Corp./DIRECTV* transaction. Finally, the longstanding network non-duplication and syndicated exclusivity rules continue to serve the invaluable public interest goals of ensuring that broadcasters (i) can protect programming rights they have bargained for in a competitive marketplace and (ii) therefore will continue to have incentives to invest in high-quality programming.

II. THE RETRANSMISSION CONSENT REGIME CONTINUES TO SERVE ITS ORIGINAL PUBLIC INTEREST OBJECTIVES

A. Retransmission Consent Rights Were Created Largely To Ensure Continued Consumer Access to Free Over-The-Air Broadcasting, A Concern That Is Even More Pressing In Today's Highly Competitive Video Services Environment

In 1992, Congress created a "retransmission consent" policy under which MVPDs must obtain "express authority" from a station before retransmitting its signal, and broadcasters have the ability to seek just compensation in exchange for such carriage rights.[1] In so doing, Congress agreed with the Commission that the inability of broadcasters to control the use of their signals created a "distortion in the marketplace which threaten[ed] the future of over-the-air broadcasting."[2] In particular, Congress recognized that "a very substantial portion of the fees which consumers pay to cable systems is attributable to the value they receive from watching broadcast signals" and that the law simply should not endorse a system "under which broadcasters in effect subsidize the establishment of their chief competitors."[3]

As the market for MVPD services has exploded, viewership of over-the-air services has declined. During the 2003-2004 television season, for example, broadcast television stations accounted for a combined average 48 share of prime-time viewing among all television households, compared to a 49 share in the previous season,[4] and a 74 share in the 1992-1993 television season.[5] In this increasingly fragmented environment, the right of broadcasters to

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1 47 U.S.C. § 325(a).

2 S. Rep. No. 102-92, at 35 (1991), reprinted in 1992 U.S.C.C.A.N. 1133, 1168.

3 *Id.*

4 *Id.*

5 *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Tenth Annual Report, 19 FCC Rcd 1606, 1615 ¶16 (2004).

compete freely in the video services marketplace, and particularly their ability to be fairly compensated for their most precious resources—their network and local programming services—are even more critical today than when the retransmission consent regime was first put in place.

B. The Offering Of Program Services In Packages To MVPDs Is A Longstanding Industry Practice That Continues To Balance The Competitive Interests Of Programmers And MVPDs

In passing the retransmission consent legislation, Congress was careful to note that its "intention [was] to establish a marketplace for the disposition of the rights to retransmit broadcast signals," and not "to dictate the outcome of the ensuing marketplace negotiations."[6] Moreover, Congress specifically anticipated that the consideration paid by a cable operator in exchange for carriage of a local signal could be "the right to program an additional channel on a cable system."[7] As the Commission well knows, this type of in-kind consideration quickly became the industry norm. This arrangement provided benefits for both sides, as MVPDs were able to obtain broadcast carriage rights at relatively low cost and programmers gained important distribution rights. Since that time, retransmission consent negotiations generally have continued to involve program deals, at the insistence of the MVPD buyers.

The FCC has endorsed the policies underlying this practice on several occasions. In establishing guidelines for "good faith negotiations," for example, the Commission deemed "[p]roposals for carriage conditioned on carriage of any other programming, such as . . . an affiliated cable programming service" as presumptively in good faith and "consistent with

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6 S. Rep. No. 102-92, at 36, 1992 U.S.C.C.A.N. at 1169.

7 *Id.* In addition, in 1999, Congress granted DBS operators a copyright license to make secondary transmissions of a broadcast station's signal into the station's local market through the adoption of the Satellite Home Viewer Improvement Act of 1999. Pub. L. No. 106-113, 113 Stat. 1501, Appendix I (1999).

competitive marketplace considerations."[8] The agency further noted in this regard that "arbitrarily limit[ing] the range or type of proposals that the parties may raise in the context of retransmission consent will make it more difficult for broadcasters and MVPDs to reach agreement."[9]

In connection with its implementation of the SHVERA, the FCC just recently reaffirmed these findings. Specifically, the Commission noted that in enacting the SHVERA, Congress did not intend for the FCC to "amend its existing good faith rules in any way other than to" extend the current good faith obligation and to extend it to MVPDs.[10] Thus, as both Congress and the FCC consistently have recognized, giving broadcasters flexibility to reach retransmission consent agreements—including by according them the option to negotiate in-kind consideration—continues to serve the public interest and to be fully consistent with a competitive marketplace.

C. Congress Did Not Intend To Regulate The Manner In Which Broadcasters Invest Any Consideration Earned From Retransmission Consent

The Joint Cable Commenters argue that broadcasters' retransmission consent rights should be eliminated because, they assert, broadcasters have not used their consent rights to "strengthen[] localism or facilitate[e] the ability of local stations to compete for marquee local

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[8] *Implementation of the Satellite Home Improvement Act of 1999*; *Retransmission Consent Issues: Good Faith Negotiation and Exclusivity*, First Report and Order, 15 FCC Rcd 5445, 5469-70 ¶56 (2000) ("*1999 SHVIA Order*"); *see also Report on the Packaging and Sale of Video Programming Services to the Public*, 2004 FCC LEXIS 6518, *201 (Media Bur. 2004) (noting that "proposals for carriage conditioned on carriage of any other programming, such as a broadcaster's digital signals, an affiliated cable programming service, or another broadcast station either in the same or a different market is presumptively consistent with competitive marketplace considerations and the good faith negotiation requirement") ("*FCC À La Carte Report*").

[9] *1999 SHVIA Order*, 15 FCC Rcd at 5469 ¶56. Similarly, in resolving a retransmission consent dispute between EchoStar and Young Broadcasting in 2001 in Young's favor, the FCC noted that "offering retransmission consent in exchange for … other programming such as a cable channel" is "consistent with competitive marketplace considerations." *EchoStar Satellite Corporation v. Young Broadcasting*, 16 FCC Rcd 15070, 15079 ¶20 (2001).

[10] *Implementation of Section 207 of the Satellite Home Viewer Extension and Reauthorization Act of 2004, Reciprocal Bargaining Obligations*, MB Docket No. 05-89, ¶7 (March 7, 2005).

programming."[11] Despite the suggestions of the Joint Cable Commenters to the contrary, the overarching objective of the retransmission consent law was to restore a fair balance to the marketplace that would help sustain the economic viability of free, over-the-air service and not to police the manner in which broadcasters would invest any earnings from retransmission consent agreements. Joint Cable Commenters present no evidence that Congress intended to usurp broadcasters' flexibility to spend any retransmission revenues in the manner that they determine to be most efficient and beneficial to continued success in the marketplace.

In any case, as explained in the attached Response of Economists Incorporated ("EI"), the existence of retransmission consent actually increases the incentives of broadcasters to improve the quality of their services.[12] This is because the quality of programming offered by a broadcaster directly corresponds to its potential to earn profits from retransmission consent. The Joint Cable Commenters do not provide any evidence demonstrating that broadcasters have not, in fact, acted on these economic incentives. Although they assert that the quality of broadcast programming has not improved since the implementation of the retransmission consent rules, the only evidence provided in support of this point is a chart purporting to show that cable expenditures on programming have grown at a faster rate in recent years than broadcast expenditures.[13] This information is meaningless, as it fails to control for the fact that the number of national subscription program services has more than tripled during the time period examined

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[11] *See* Comments of Joint Cable Commenters at 32 ("Joint Cable Comments"); all comments cited herein were submitted in MB Docket No. 05-28 on March 1, 2005.

[12] *See* Michael G. Baumann and Kent W. Mikkelsen, Economists Incorporated, *Response to Comments Regarding Economic Consequences of Retransmission Consent*, at 12-14 (March 31, 2005) (Attachment 1) ("EI Response").

[13] *See* Joint Cable Comments, Exhibit 2, William P. Rogerson, Professor of Economics, Northwestern University, *The Social Cost of Retransmission Consent Regulations*, at 55-56 ("Rogerson Report").

and does not even incorporate expenditures on local or syndicated programming.[14] The observation that cable now represents a greater share of Emmy awards than it did in 1993 suffers from the same fundamental flaw. Finally, that the number of broadcast hours devoted to "unscripted" programming has increased since 1993 is a subjective observation that has no empirical meaning.

III. THERE IS NO MERIT TO SUGGESTIONS THAT BROADCASTERS' EXERCISE OF RETRANSMISSION CONSENT RIGHTS HAS CREATED A MARKETPLACE IMBALANCE OR HAS ADVERSELY IMPACTED CONSUMERS

A. Marketplace Realities Contradict MVPD Assertions That Broadcasters Have Undue Leverage In Retransmission Consent Negotiations

EchoStar, the Joint Cable Commenters, and ACA uniformly emphasize that carriage of local stations continues to be "highly valued by consumers" and "critical to MVPD offerings."[15] Despite their repeated acknowledgements of the important role that carriage of local signals plays in the appeal of their services to subscribers, and thus of the inherent economic value that such services have to MVPDs, these commenters apparently believe that broadcasters should not be compensated for the carriage of their local signals. In essence, they seek to eviscerate the marketplace value of local over-the-air services and, thereby, to regress to the unbalanced environment that existed prior to the enactment of the retransmission consent statute. Aside from the fact that such an inequitable system would provide multichannel video distributors with

[14] *See* EI Response at 13.

[15] Comments of EchoStar Satellite L.L.C. at 3 ("EchoStar Comments"); *see also* Joint Cable Comments at 12-13. As EI explains in its Response, "[c]able carriage of local station signals produces revenue for cable operators," as an operator "may charge a higher subscription price for a package of programming if local broadcast stations are included" and "at any given subscription price, there will be more subscribers and more subscription revenue if local broadcast signals are carried." *See* EI Response at 3. Further, "having more subscribers means that the cable operator can generate more revenue from the sale of local advertising and other services." *Id*.

a financial windfall, these parties provide no legitimate reason why broadcasters should be deprived of the right to fair economic compensation for their admittedly valuable services.

Moreover, the Joint Cable Commenters and EchoStar profess to have little to no bargaining power in retransmission consent negotiations.[16] The Commission already has correctly recognized the fallacy of these commenters' portrayal of the marketplace. As the agency found in its recent *News Corp./DIRECTV* decision, the relative bargaining positions of broadcasters and MVPDs in the context of retransmission consent negotiations generally are reasonably balanced, with "[b]oth programmer and MVPD benefit[ing] when carriage is arranged."[17] As the FCC explained, "the station benefits from carriage because its programming and advertising will likely reach more households when carried by MVPDs than otherwise, and the MVPDs benefit because the station's programming adds to the attraction of the MVPD subscription to consumers."[18] Thus, "the local television broadcaster and the MVPD negotiate in the context of a roughly even 'balance of terror' in which the failure to resolve local broadcast carriage disputes through the retransmission consent process potentially *damages each side greatly* in their core business endeavor."[19]

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16 Joint Cable Comments at 1, 14; EchoStar Comments at 9; *see also* Comments of American Cable Association at 7-11 ("ACA Comments").

17 *General Motors Corporation and Hughes Electronics Corporation, Transferors And The News Corporation Limited, Transferee, For Authority to Transfer Control,* Memorandum Opinion and Order, 19 FCC Rcd 473, 556 ¶180 (2004) ("*News Corp./DIRECTV Order*"); *see also* EI Response at 2 (explaining that "[b]oth MVPDs and television stations benefit when stations are carried on MVPDs").

18 *News Corp./DIRECTV Order,* 19 FCC Rcd at 556 ¶180.

19 *Id.* (emphasis added). This balance is a factor not just in broadcasters' carriage negotiations with the largest multi-system operators, but also in their dealings with smaller MVPDs. It is critical for Viacom and other broadcasters to have their services viewed by as broad an audience as possible, and overall, small operators provide service to a substantial portion of U.S. viewers. Furthermore, many small MVPDs operate in rural areas where over-the-air reception is unavailable and MVPD services provide the only means to view both broadcast and subscription programming. In such areas, achieving MVPD carriage takes on even greater importance.

Contrary to EchoStar's assertion, and as the agency itself expressly has clarified, the Commission most emphatically did *not* "definitively" (or otherwise) find in *News Corp./DIRECTV* that all broadcasters have anticompetitive market power in retransmission consent negotiations.[20] Rather, the decision was based only on the shift in bargaining power that the Commission believed could result from the proposed vertical integration of an MVPD and a broadcast network.[21] Even more to the point, the agency since has expressly stated that "nothing in the analysis of the *News Corp./DirecTV* transaction should be read to suggest that the Commission has concluded that the market power of broadcasters is sufficient to lead to competitive harms in the absence of vertical integration."[22]

The evidence that a fair "balance" exists in retransmission consent negotiations can be seen in the marketplace. Last year's well-publicized contract negotiations between EchoStar and Viacom provides an excellent illustration that the current system works. In those negotiations, Viacom sought to have EchoStar carry more programming services and give those services broader distribution, while EchoStar negotiated to carry fewer channels and place them on different tiers. In the end, EchoStar's CEO acknowledged that his company had successfully negotiated a deal that was "good enough" for both parties[23]—demonstrating that these private contract disputes typically involve parties who are quite clearly capable of looking out for their

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20 *See* EchoStar Comments at 5.

21 *See News Corp./DIRECTV Order*, 19 FCC Rcd at 568 ¶¶208-09 (concluding that "the transaction will increase News Corp.'s post-transaction incentive and ability to temporarily withhold access to the signals of its television broadcast stations as a negotiating tactic by lowering the risks of and costs to News Corp. of engaging in such foreclosure"). As then-Chairman Powell underscored in his separate statement in that proceeding, the Commission's action was based solely on "merger-specific harm[s]" relating to the transaction at issue. *Id.* (Separate Statement of Chairman Michael K. Powell, at n. 2).

22 *See FCC À La Carte Report*, 2004 FCC LEXIS 6518, *206.

23 *See, e.g.*, John M. Higgins, *The Blackout Backfired*, Broadcasting & Cable (March 15, 2004).

own interests without governmental intervention, and that the "balance of terror" leads to just the kind of open market resolution that tough bargaining and tough competition encourages.

B. Retransmission Consent Has Had No Appreciable Impact On Cable Rate Increases

The Joint Cable Commenters attempt to hold *broadcasters* responsible for the recent rise in cable rates, arguing that the exercise of retransmission consent by the stations owned-and-operated by the Top-4 broadcast networks has been the "principal driver" behind the recent increase in prices cable operators choose to charge their subscribers.[24] Specifically, the Joint Cable Commenters allege that they have been "forced" to add a number of broadcast-affiliated networks to the most popular cable programming tiers since the implementation of retransmission consent and that these new channels have been a "significant contributor" to cable rate increases.[25] These arguments are unsupported by valid economic analysis and fail to take into account any other expenses faced by MVPDs aside from a subset of their programming fees.

In reality, the growth in retail cable rates charged by MVPDs has far outstripped programmers' license fee increases. As shown in the attached EI Response, an analysis of the license fees for the program networks that the Joint Cable Commenters and ACA themselves aver they are "forced" to carry highlights the disparity between cable rate increases and changes in license fees for broadcast-affiliated networks.[26] Although Viacom disagrees with the

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[24] *See* Joint Cable Comments at 40-46.

[25] *Id*. at 40-45.

[26] *See* EI Response at 10-11; *see* Rogerson Report at 34, Table 9 (*citing* Comments of American Cable Association, in MB Docket No. 04-207, *À La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite*, at 33 (July 15, 2004) ("ACA À La Carte Comments"). There are 27 program networks on the list of program networks compiled by ACA and cited in the Rogerson Report that cable operators allegedly are "forced" to carry. The EI analysis includes 25 of these networks, because license fee information for the remaining two networks (Fuel and Shop NBC) is not publicly available. *See* EI Response at 10.

contention that MVPDs are ever compelled to carry affiliated program networks as a condition of retransmission consent,[27] a review of the license fees associated with these networks is useful here. The average cable rates charged to subscribers increased by a whopping $14.98, or nearly 58 percent, between 1997 and 2004.[28] By contrast, the fees for the networks Joint Cable Commenters and ACA represent that they are compelled to carry increased only by approximately $2.50 during this period, thus representing only about 17 percent of the overall rate increase.[29] Moreover, as the Government Accounting Office (GAO) concluded in a recent report on the cable industry, "cable networks affiliated with broadcasters or cable operators do not receive higher license fees . . . than nonaffiliated networks."[30]

Since cable operators inevitably would be carrying—and paying license fees for—other program networks if they were not carrying these broadcast-affiliated networks, it is not at all clear that the existence of retransmission consent has had any appreciable impact on cable rates. In any case, the share that broadcast-affiliated networks represent on typical cable systems has *not* increased since the retransmission consent regime was put in place in the early 1990s.[31] In fact, EI demonstrates in its Response that of the currently existing cable networks, the Top-4

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27 *See, e.g.*, Comments of Viacom, in MB Docket No. 04-207, *À La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems*, at 11-12 (July 15, 2004) (explaining that Viacom does not "force" MVPDs to carry any of its program services). In fact, as programmers today provide consumers with an incredibly rich diversity of highly desirable services. *See id*. at 5-8.

28 *See* EI Response at 11.

29 *See id*.

30 *See*, *e.g.*, Government Accounting Office, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, Highlights of GAO-04-8, Telecommunications (October 2003) ("2003 GAO Report"); *see also* Government Accounting Office, *Subscriber Rates and Competition in the Cable Television Industry*, Highlights of GAO-04-262T, Telecommunications (March 25, 2004); *see also* 2003 GAO Report at 29 ("ownership affiliations—with broadcasters or with cable operators—had no influence on cable networks' license fees").

31 *See* Joint Cable Comments at 41.

broadcast networks' ownership share of those launched since 1992 is eight percent lower than their share of those launched prior to 1993.[32]

Furthermore, the claims made by Joint Cable Commenters utterly ignore the impact that other significant expenditures almost certainly have had on recent rate increases. Among the expenses that Joint Cable Commenters fail to discuss are system upgrades; marketing expenses; customer service improvements; payroll and benefits for executives, talent, and other employees; office rents and other expenses; IT and telecommunications costs; and license fees for program networks not affiliated with broadcasters.[33] To our knowledge, none of these other cost items is subject to regulation of the type that has been proposed here.

IV. <u>INTERVENTION IN THE CURRENT RETRANSMISSION CONSENT REGIME IS WHOLLY UNNECESSARY AND WOULD UNDERMINE THE HEALTHY FUNCTIONING OF THE MARKETPLACE</u>

A. The Exchange of Retransmission Consent For Carriage Of Affiliated Program Services Does Not Violate The Antitrust Laws

EchoStar repeats its argument from prior proceedings that the exchange of retransmission consent for carriage of affiliated program services should be banned as a "*per se* illegal tie under the antitrust laws."[34] And, as it has done in the past, EchoStar mischaracterizes the relevant antitrust jurisprudence. In fact, the practice of allowing carriage of other broadcast or non-broadcast services as consideration for retransmission consent is fully consistent with well-established antitrust precedent.

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32 *See* EI Response at 9.

33 *See* 2003 GAO Report at 25-26 (noting that in addition to programming costs, the cable industry recently has incurred other increased costs, including infrastructure upgrades and customer service improvements).

34 *See* EchoStar Comments at 4-6 (requesting that the agency "abolish any 'presumption'" that that tying arrangements are "consistent with competitive marketplace considerations"); *see also* Comments of EchoStar Satellite L.L.C., in MB Docket No. 04-207, *À La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite*, at 3-7 (July 15, 2004).

The Supreme Court's decision in *Jefferson Parish Hospital District. No. 2 v. Hyde* is the starting point for analyzing tying and bundling arrangements under the antitrust laws.[35] As Justice O'Connor stated in her oft-cited concurrence in that case, "a tie has been illegal only if the seller is shown to have sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product…."[36] This is because there is nothing inherently anticompetitive about tying or bundling. In fact, "[b]uyers often find package sales attractive; a seller's decision to offer such packages can merely be an attempt to compete effectively—conduct that is entirely consistent with the Sherman Act."[37]

The mere linking of retransmission consent with carriage of affiliated cable networks is not enough to establish the requisite market power under an antitrust claim. Contrary to EchoStar's suggestion, it is not sufficient for a plaintiff to demonstrate that a network-owned station merely possesses *some* degree of market power. Rather, it must show that such power is adequate to coerce acceptance of the tied product.[38] As EI explains, this degree of market power is absent in current retransmission consent negotiations.[39] For example, Viacom's CBS network currently commands only about an 11 percent share of primetime viewing, well below the

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[35] 466 U.S. 2 (1984).

[36] *Id*. at 34 (internal citation omitted).

[37] *Id*. at 12. Relying on *Jefferson Parish,* lower courts now generally require antitrust plaintiffs to prove, *inter alia*, the following elements to state an unlawful tying claim: (1) sufficient economic power in the tying product market to coerce the purchase of the tied product; (2) evidence of actual coercion; and (3) an appreciable effect on competition in the tied market. *See, e.g., Hack v. President and Fellows of Yale Coll.*, 237 F.3d 81, 86 (2d Cir. 2000).

[38] *Hack v. Yale,* 237 F.3d. at 86 (an antitrust plaintiff must establish that a seller has "*sufficient* economic power in the tying market to *coerce* purchaser acceptance of the tied product") (emphasis added).

[39] *See* EI Response at 5-8.

threshold that courts have found to produce anticompetitive effects.[40] Thus, a reviewing court almost certainly would reject any claim that a non-vertically integrated broadcaster has coercive market power to tie its affiliated program services to retransmission consent.

There also is no basis to find either evidence of actual coercion or an appreciable effect on competition in the tied market—the other two required elements of an unlawful tying claim—in the context of retransmission consent negotiations.[41] In light of the "roughly even 'balance of terror'" that characterizes the positions of MVPDs and broadcasters in such negotiations, it is evident that neither side has coercive power over the other. Given the absence of such power, it is an *a fortiori* proposition that neither party is in a position to demonstrate the *actual exercise* of coercive power by the other.

In addition, there is absolutely no basis for a finding that linking retransmission consent rights to carriage of affiliated cable programming has had an appreciable effect on competition in a putative tied market (*i.e.*, cable programming). As explained by EI, the broadcast networks in the aggregate currently have ownership interests in only 23 percent of the existing satellite-delivered national program networks, thus making it highly unlikely that "any broadcast network will gain a share that would give it anticompetitive market power."[42] Under the Herfindahl-Hirschman Index traditionally used to measure economic concentration, this percentage would correlate to an HHI of approximately 467, which, again, is considerably lower than levels

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[40] *Id*. at 5. Since *Jefferson Parish*, "no court has inferred the requisite market power [to state a tying claim] from a market share below 30 percent." ABA Section of Antitrust Law, *Antitrust Law Developments*, at 196, n. 1111 (5th ed. 2002). Moreover, "[c]ourts have consistently refused to consider one brand to be a relevant market of its own when the brand competes with other potential substitutes." *Hack v. Yale*, 237 F.3d at 86 (*quoting Little Caesar Enterprises, Inc. v. Smith*, 34 F. Supp. 2d 459, 477, n. 30 (E.D. Mich. 1998)).

[41] *See Hack v. Yale*, 237 F.3d at 86.

[42] EI Response at 6.

associated with anticompetitive market power under the antitrust laws.[43] Moreover, of the 49 satellite-delivered national networks that were launched in between June 2003 and June 2004, only three—or approximately six percent—were owned by any of the major broadcast networks.[44]

B. Commenters Provide No Basis For The Imposition Of Broad And Burdensome Restrictions On Retransmission Consent Negotiations

Despite the FCC's clear and repeated conclusions that the findings in *News Corp./DIRECTV* were uniquely applicable to that specific transaction, both EchoStar and ACA ask the FCC for a wholesale imposition of the retransmission consent-related conditions imposed on that transaction on all broadcasters.[45] These parties offer no legitimate explanation of why these transaction-specific conditions should be imposed on all broadcasters. As discussed above, such intervention is not needed to correct any competitive imbalance. Moreover, these efforts to restrict or eliminate local broadcasters' retransmission consent rights needlessly would eviscerate the competitive objectives that Congress and the Commission sought to achieve in establishing and implementing the retransmission consent regime.

In addition, commenters to both this and prior Commission proceedings have asked the FCC either to promulgate rules or recommend legislative proposals that would impose a "non-discrimination" condition on the terms and conditions offered by broadcasters in retransmission consent negotiations.[46] The basis for asking the agency to usurp broadcasters' flexibility to

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[43] *Id*. at 7.

[44] *Id*. at 8 (*citing Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eleventh Annual Report, MB Docket No. 04-227, ¶145 (Feb. 4, 2005)).

[45] *See* EchoStar Comments at 10-12; ACA Comments at 3; *see also* Comments of BellSouth Corporation and BellSouth Entertainment, L.L.C. at 8 (requesting mandatory arbitration before a broadcast station is permitted to withdraw retransmission consent) ("BellSouth Comments").

[46] *See, e.g.*, BellSouth Comments at 8; ACA À La Carte Comments at 6.

negotiate individualized retransmission consent agreements is the belief that, because small or alternative MVPDs may have fewer subscribers than incumbent cable operators, "broadcasters actually have an economic incentive to impose anticompetitive retransmission consent agreements" on them.[47] This concern is illogical. Broadcasters have strong incentives to have their signals carried to as many households as possible. Whether such carriage is achieved via incumbent cable or other MVPDs is irrelevant. In fact, carriage by alternative providers can be particularly important in rural areas where cable is unavailable. In any case, broadcasters certainly do not have any incentive to offer *any* potential carriers of their services unacceptable or "anticompetitive" carriage terms.[48]

Moreover, to the extent that an MVPD may believe that an individual broadcaster has acted in bad faith in the context of retransmission consent negotiations, there already is a comprehensive complaint process in place at the FCC that is sufficient to resolve such concerns and to provide the aggrieved distributor with a remedy.[49] No commenter to this proceeding has suggested that this complaint process is in any way insufficient to deal with specific instances of bad faith negotiations.

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[47] BellSouth Comments at 6.

[48] BellSouth further asks the Commission to prohibit broadcasters from imposing "non-optional tying" of digital signals to retransmission consent for analog signals. *See* BellSouth Comments at 8. It is not clear what BellSouth means by "non-optional," as it notes that the FCC already has decided that broadcasters are not entitled to mandatory carriage of both their analog and digital signals or for multicast channels. In any case, BellSouth provides absolutely no reason why the agency should impose such a restriction on broadcasters.

[49] *See* 47 C.F.R. § 76.7.

V. <u>IT IS CRITICALLY IMPORTANT TO THE BROADCAST INDUSTRY TO PRESERVE THE EXCLUSIVITY PROTECTIONS ACCORDED TO ITS PROGRAMMING</u>

Both cable and DBS commenters in this proceeding argue that they should have increased ability to import distant broadcast signals.[50] Indeed, the National Cable & Telecommunications Association ("NCTA") asks the Commission to completely eliminate the exclusivity rights of broadcasters that choose to exercise their retransmission consent rights.[51] NCTA further claims that broadcasters should be stripped of their retransmission consent rights with respect to cable operators that import distant broadcast signals and are located in markets in which DBS operators have the ability to carry distant signals.[52]

As explained in detail in the Comments of the National Association of Broadcasters in this proceeding, the network non-duplication and syndicated exclusivity rules, like the retransmission consent regime, were created in order to "enhance competition in the video marketplace by eliminating unfairness to broadcasters."[53] More specifically, the FCC has recognized that exclusivity protections are needed to "preserve to local stations the credit to

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[50] *See* Comments of National Cable & Telecommunications Association at 2 ("NCTA Comments"); *see also* EchoStar Comments at 13-14.

[51] NCTA Comments at 12. In addition, ACA asserts, without explanation, that broadcasters use their exclusivity rights "solely to raise the 'price' of retransmission consent" and that the FCC thus should "address the serious harm caused by abuse of broadcast exclusivity." ACA Comments at 4; *see also* Joint Cable Comments at 14 (asserting that the network non-duplication and syndicated program exclusivity rules "further enhanc[e broadcasters'] negotiating leverage during retransmission consent negotiations," but acknowledging that these rules "exist for . . . valid policy reasons").

[52] NCTA Comments at 12.

[53] Comments of the National Association of Broadcasters at 7 (*citing Amendment of Parts 73 and 76 of the Commission's Rules Relating to Program Exclusivity in the Cable and Broadcast Industries*, Report and Order, 3 FCC Rcd 5299, 5313 ¶89 (1988)) ("NAB Comments").

which they are entitled . . . for presenting programs for which they bargained and paid in the competitive marketplace."[54]

Restricting the ability of local television stations to protect their programming investments is unnecessary and would be highly prejudicial to the broadcast industry. Such measures unquestionably would have a devastating impact on the incentives of broadcasters to invest in high-quality programming, and it would be illogical for the Commission to take *any* action that would curtail the rights of local broadcasters to preserve the exclusivity rights they have fairly "bargained and paid" for in the marketplace.

VI. CONCLUSION

Viacom respectfully submits that the FCC should report to Congress that the existing retransmission consent and broadcast exclusivity statutory and regulatory schemes continue to be necessary to serve the public interest and should be maintained in their current form.

Respectfully submitted,

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[54] NAB Comments at 6 (*citing Amendment of Subpart L, Part 11 to Adopt Rules and Regulations to Govern the Grant of Authorization in the Business Radio Service for Microwave Stations to Relay Television Signals to Community Antenna Systems*, First Report and Order, 38 FCC 683, 715 (1965)).

ATTACHMENT 1

Response to Comments Regarding Economic Consequences of Retransmission Consent

by

Michael G. Baumann and Kent W Mikkelsen

March 31, 2005

ECONOMISTS INCORPORATED

Response to Comments Regarding Economic Consequences of Retransmission Consent

Michael G. Baumann and Kent W Mikkelsen

I. Introduction

Viacom has asked us to respond to certain points raised by certain commenters[1] in the Commission's current proceeding.[2]

1. Commenters state that owners of broadcast television stations, including Viacom, have "market power" that is used in the negotiation of retransmission consent. Furthermore, they claim that when retransmission consent is granted in return for agreement to carry non-broadcast MVPD programming, this results in harm to competition in the market for MVPD programming.
2. Commenters state that retransmission consent has been a major factor in rising cable rates paid by consumers.
3. Commenters state that retransmission consent has brought little or no benefit to consumers.

Our response can be summarized as follows:

1. Viacom and other owners of broadcast television stations have "market power" only in the limited sense that they have some discretion over price, a feature shared with many firms in the economy. Viacom does not have the type or degree of market power that leads to harm to competition or to consumers. Moreover,

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[1] The comments to which we respond include Comments of Joint Cable Commenters ("JCC"), Comments of EchoStar Satellite L.L.C. ("EchoStar"), Comments of the American Cable Association ("ACA") and William P. Rogerson, "The Social Cost of Retransmission Consent Regulations" ("Rogerson").

[2] In the Matter of Inquiry Required by the Satellite Home Viewer Extension and Reauthorization Act on Rules Affecting Competition in the Television Marketplace, MB Docket No. 05-28.

obtaining carriage of non-broadcast MVPD programming in return for retransmission consent does not harm competition in the market for MVPD programming.

2. Retransmission consent has not been a major factor contributing to the increase in cable rates.
3. Retransmission consent provides incentives to television stations and broadcast networks to increase investment in programming.

II. Market Power and Competitive Effects

The 1992 Cable Act established two methods by which cable systems carry local broadcast station signals—must carry and retransmission consent. Under must carry, cable systems are not required to pay local broadcast stations for the right to distribute the local broadcast station signals that they are required by federal law to carry. Alternatively, a local broadcast station may elect to exercise its right to grant retransmission consent. Under retransmission consent, cable systems are not required to carry the local broadcast station's signal, but must negotiate compensation with the local broadcast station if they decide to carry the broadcast station's signal. Similarly, under the Satellite Home Viewer Improvement Act of 1999, satellite operators must negotiate with local television stations to carry their signals.

Both MVPDs and television stations benefit when MVPDs carry the stations. The MVPD benefits because, like other programming it carries, the programming from television stations helps the MVPD attract and retain subscribers, from which it derives subscription revenues. A station benefits because carriage increases the station's audience, and this tends to increase the revenues that the station can obtain from advertisers. In the bargaining that ensues, it has typically been the case that MVPDs have paid some compensation to the television station.

It is not surprising that arm's length, free market negotiations between stations and MVPDs would result in compensation being paid to the television stations. MVPDs pay for the other programming that they carry, so it is not unusual for them to pay for television stations' programming.

Cable carriage of local broadcast station signals produces revenues for cable operators. A cable operator may charge a higher subscription price for a package of programming if local broadcast station signals are included in the package. Alternatively, at any given subscription price, there will be more subscribers and more subscription revenue if local broadcast station signals are carried. Further, having more subscribers means that the cable operator can generate more revenue from the sale of local advertising and other video and non-video services. In these respects, local broadcast station signals play a role similar to popular cable networks and other sources of cable content.

To evaluate the claims made by commenters, it is useful to have an understanding of the term "market power." Under idealized conditions that economists call "perfect competition," competition forces the price at which a firm sells its product to be equal to marginal cost. Economists describe a firm that can consistently sell its product for a price higher than marginal cost as having "market power."

One condition for perfect competition is that there be many firms producing goods that are perfect substitutes for each other. Since firms in many sectors of the economy produce products for which there is no perfect substitute, many firms have some degree of market power. A firm may have market power but still only earn a competitive rate of return or profit due to competition from producers of competing, but somewhat differentiated, products.[3]

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[3] See, Carlton and Perloff, Modern Industrial Organization, Fourth Edition (2005). "A [firm] can set its price above its marginal cost but does not necessarily make a supracompetitive profit. For example, if a [firm] incurs a fixed cost, its profit may be zero (the competitive level) even if its price exceeds its marginal cost." (p. 93); also see, Landes and Posner, "Market Power in Antitrust Cases," Harvard Law Review, Vol. 94, No. 5 (March 1981), pp. 937-983. "… each seller … may have had an average cost greater than its marginal cost, and possibly equal to its price, because each may have incurred (fixed) costs to develop brands that would enjoy the strong consumer preference reflected in [their] elasticity estimates. Even if firms succeed in reducing the elasticity of demand for their brands in this way, they will not have any monopoly profits if there is competition among firms, and consumers will benefit from the better quality and greater variety of products." (p. 957)

Some commenters have stated or implied that television stations, and in particular the television stations affiliated or owned by the four major broadcast networks, have a troubling level of market power.[4] They do so based on Commission statements in the News Corp./DirecTV decision that television stations have market power in retransmission consent negotiations.[5] But commenters do not tell the whole story. To obtain a fuller view of the Commission's position, it is worth quoting the Commission's statement at length:

> Certain parties have argued that the Commission's analysis of the [News Corp/DirecTV] transaction bears some relevance on the present discussion. This represents a misunderstanding of the nature of the Commission's transaction review process as well as the specifics of the transaction between News Corp. and Hughes Electronics. The transaction review process at the Commission is directed at examining *changes* in the competitive landscape that are a direct result of the transaction at issue. To the extent the Commission discussed the "market power" that might reside in the combined entity, it was not passing upon the competitive balance of negotiating power that normally exists between broadcasters/programmers and MVPDs. All differentiated products, such as video programming, possess some degree of market power in the sense that there are no perfect substitutes. The critical question in any analysis involving differentiated products is whether the existing degree of market power is sufficient to allow the firm to profitably engage in the hypothesized anticompetitive activity. In the News Corp. transaction, the potential refusal to sell to competing MVPDs, or vertical foreclosure, was the activity of concern. Commission staff rigorously measured News Corporation's incentive and ability post-transaction to engage in the hypothesized activity and determined that, while permanent foreclosure was unlikely, temporary foreclosure was a real public interest concern. Thus, nothing in the analysis of the News Corp./DirecTV transaction should be read to suggest that the Commission has concluded that the market power of broadcasters is sufficient to lead to competitive harms in the absence of vertical integration.[6]

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[4] See, for example, JCC at 6 and 13; EchoStar at 4 and 5; ACA at 7; and Rogerson at 20.

[5] See, for example, JCC at 13; EchoStar at 3; ACA at 10; and Rogerson at 24-27.

[6] FCC, *Report on the Packaging and Sale of Video Programming Services to the Public*, November 18, 2004, p. 70. Footnotes omitted.

As this quotation shows, the market power which the Commission has found that television stations possess is of the ordinary variety that many firms have, as discussed above. The Commission has not concluded that this market power leads to competitive harm in the absence of vertical integration with an MVPD. As discussed below, this conclusion is consistent with the application of standard economic principles and norms.

The programming available to an MVPD is best viewed as a continuum running from the most effective to the least effective (per dollar cost to the MVPD) in attracting subscribers. Programming retransmitted from any local broadcast television station has a place in the continuum, but is substitutable with other broadcast and non-broadcast programming of equal effectiveness. In retransmission consent negotiations, the ability of MVPDs to substitute other broadcast and non-broadcast programming constrains the market power of an individual television station.

One indicator of market power would be a television station's or cable network's share of revenues in the sale of their programming rights to a cable operator. Data on such revenues are not available. As a proxy, one can look at the audience share that each station or network has, since audience size should represent at least roughly the relative attractiveness of stations and networks to distributors. For the current television season from September 20, 2004 through February 27, 2005, CBS affiliated stations on average received only about 11 percent of prime time viewing.[7] Such a share is well below the levels at which economists expect to see market power that would produce anticompetitive results.

Broadcasters and cable operators, operating under rules established by the FCC, negotiate retransmission consent agreements that can be complex. Cable operators often choose to provide alternative consideration, such as carriage of cable networks that are affiliated with the broadcaster, in lieu of cash payment. Commenters have suggested that this

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[7] NTI, 20 September 2004 – 27 February 2005. The CBS network has a 14 share of primetime viewing. Due to multi-set use in households, the total primetime share is 125. So, while the CBS network is viewed in 14 percent of households, it only accounts for about 11 percent of all viewing.

practice leads to competitive harm in the programming market, either by significantly increasing concentration in that market or by foreclosing the entry of new programming services.[8] However, this suggestion is unfounded. Even if television stations had considerably more market power than they do, it is unlikely that carriage agreements growing out of retransmission consent negotiations would lead to a significant reduction in competition because there is ample competition in the MVPD programming market and relatively easy entry.

The Commission recently reported that there are 388 satellite-delivered national programming networks.[9] Of these, only 89, or 23 percent, are owned by one or more national broadcast networks. The Commission found that Viacom had an ownership interest in 10 percent of all satellite-delivered national programming networks, ABC/Disney in 5 percent, NBC-Universal in 4 percent and Fox in 3 percent. Each of these shares is far too low to give any broadcast network the incentive to foreclose entry by other video programming providers. Furthermore, it is unlikely that any broadcast network will gain a share that would give it anticompetitive market power.

Research conducted at Economists Incorporated in early 2004 supports these findings. Using data provided by the Commission and other public sources, information was compiled on the ownership and subscriber count for as many as possible of 266 satellite-delivered national programming networks listed in the Commission's Tenth Annual Report.[10] Both basic and premium networks were included. Each network was assigned

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[8] See, for example, JCC at 18-20; EchoStar at 4; and Rogerson at 6-10 and 47-48.

[9] FCC, *Eleventh Annual Report*, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, MB Docket No. 04-227, Released: February 4, 2005 ("Eleventh Annual Report"), especially ¶¶ 145-8.

[10] FCC, *Tenth Annual Report*, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, MB Docket No. 03-127, Released: January 28, 2004 ("Tenth Annual Report"), Tables C-1 and C-2.

to a single owner.[11] When added together the companies that own the four major broadcast networks were the attributed owners of 23.7 percent of the 266 networks listed. The HHI based on the number of networks attributed to various owners was 467.[12] See Appendix A. These share numbers are well below levels associated with anticompetitive market power, and an HHI in this range is considered unconcentrated.[13]

Economists Incorporated conducted a second analysis on the 205 networks for which subscriber data were available. When the networks each owner has were weighted by the subscriber count of each network, Viacom's share was 16.9 percent, well below levels associated with anticompetitive market power. Together, the owners of the four major broadcast networks accounted for 33.7 percent. The HHI was 730, well within the range considered unconcentrated. See Appendix A.

Revenue shares are another way to measure the competitive significance of broadcast networks in the market for MVPD programming. Table 2 of Professor Rogerson's paper presents shares of revenues that various ownership groups derive from basic cable networks. Assuming his figures are correct, Viacom's share of revenues is 17.7 percent, and overall concentration, as measured by an HHI, is 1,233.[14] This is consistent with the revenue-weighted results reported in Appendix A. That analysis of 2003 data concluded that the HHI was 1,195 for basic cable network revenue. HHIs in this range are

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[11] Usually, the attributed owner had a majority ownership. In some cases, two owners each had a 50 percent share; in such cases, ownership was attributed to the owner with the larger number of other networks, so as to tilt the calculation towards showing higher concentration. When no ownership information could be determined, and when no owner had above 49 percent, a network was assumed to be owned independently.

[12] The Herfindahl-Hirschman Index ("HHI") is calculated as the sum of the squares of the shares of individual participants. The HHI can range between 10,000 and a number near zero.

[13] See, U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines*, Revised April 8, 1997, Section 1.51. The spectrum of market concentration as measured by the HHI is divided into three regions that can be broadly characterized as unconcentrated (HHI below 1000), moderately concentrated (HHI between 1000 and 1800), and highly concentrated (HHI above 1800).

[14] For purposes of calculating an HHI, it was assumed that the 13.3 percent of revenue attributed to "others" in Professor Rogerson's table was owned by 13 firms each having an equal share of about 1 percent of revenue.

considered to be moderately concentrated. No owner, including Viacom, has a share that approaches the levels associated with anticompetitive market power.

The Commission also reported an increase of 49 satellite delivered national programming networks in 2004 relative to 2003.[15] Comparing the Commission's listing of national video programming services in 2003 and 2004, we identified only three new services that were owned by one of the four major broadcast networks: ESPN Desportes (owned by Disney and Hearst); History Channel en Español (owned by Disney, NBC, and Hearst); and The Movie Channel HD (owned by Viacom).[16] Furthermore, the Commission found that there were 78 programming services that have been planned but are not yet operational, an increase of 17 over last year.[17] We identified only 6 of these services as being affiliated with one of the four major broadcast networks. This is evidence that carriage agreements that result from retransmission consent negotiations have not foreclosed entry into cable programming.

III. Retransmission Consent and Cable Rates

Commenters have argued that retransmission consent by the four major broadcast networks has been a major cause of cable rate increases. This argument rests on three unsubstantiated propositions: first, that the increase in the number of networks carried by cable operators is driven largely by retransmission consent, second, that increases in cable rates are due principally to retransmission consent-driven increases in the number of networks carried by cable operators, and third, that broadcasters are able to use retransmission consent to leverage increases in license fees for other broadcast-affiliated cable networks.

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[15] Eleventh Annual Report, ¶ 145.

[16] Eleventh Annual Report, Tables C-1 and C-2, and Tenth Annual Report, Tables C-1 and C-2.

[17] Eleventh Annual Report, ¶ 152 and Table C-5.

As detailed by the Commission, there has been substantial growth in the number of cable networks available, the vast majority of which are not affiliated with the four major broadcast networks.[18] Not only has retransmission consent not had a significant, demonstrated effect on the increase in the number of channels carried, it has not led the broadcast networks to account for a "disproportionate share of new channels" that have been added.[19] Kagan's *Economics of Basic Cable Networks* (2005) lists 120 basic cable networks. Of these, 31 are listed as having launched prior to 1993 and 89 as having launched since 1992. Of the 89 networks that launched since 1992, 39 networks, or 44 percent, are listed as currently affiliated with one of the four major broadcast networks. Note that they may not have been affiliated with a broadcast network when launched. By comparison, 16 out of 31, or 52 percent, of the networks that were launched prior to 1993 are listed as currently affiliated with one of the four major broadcast networks.

Commenters' second claim, that increases in the cable rates are due principally to retransmission consent-driven increases in the number of channels carried by cable operators, also appears to be unsubstantiated. There is evidence that the increase in cable rates has far outstripped the increase in cable network license fees. In its recent report on cable industry prices, the Commission found that between January 1, 2003 and January 1, 2004, the average rate for basic and expanded basic service increased by $2.09 per subscriber per month.[20] The Commission also found that programming expenses for basic and expanded basic cable television service increased by only $1.06 per subscriber per month.[21] Hence, the Commission found that only about half of the cable rate increase

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[18] The Commission reported that the number of national, non-broadcast networks increased from 106 in 1994 to 388 in 2004. See, Eleventh Annual Report, ¶ 15.

[19] JCC, p. 5.

[20] FCC, *Report on Cable Industry Prices*, In the Matter of Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment, MM Docket No. 92-266, Released: February 4, 2005 ("Report on Cable Industry Prices"), ¶ 25.

[21] Report on Cable Industry Prices, ¶ 32.

from 2003 to 2004 was needed to cover the increase in programming expenses. Similarly, a study by Professor Rogerson found that only 42 percent of the increase in basic and expanded basic cable rates between 1999 and 2002 was necessary to cover the increased cost of programming.[22] The GAO also found that in addition to programming costs, the cable industry has incurred other increased costs, including expenditures to upgrade its infrastructure and expenditures to improve customer service.[23]

Since the increase in total license fee expenses accounts for only a fraction of the increase in cable rates, it is hard to see how new channels added due to retransmission consent have driven cable rate increases. Moreover, new channels allegedly carried due to retransmission consent account for only a small portion of the increase in programming costs. Professor Rogerson presents a table listing 27 cable program networks allegedly carried because of retransmission consent as reported by the ACA.[24] This list probably exaggerates the significance of retransmission consent, since it is likely that some or most of these networks would be carried anyway. While neither confirming nor validating this list, we adopt it for purposes of examining whether cable networks carried as a result of retransmission consent drive cable rates. License fee information for 25 of the 27 networks is available from Kagan's *Economics of Basic Cable Networks* (2005).[25] To determine the impact of carrying these networks on the license fee cost for the average subscriber, a weighted sum of these license fees was calculated with each network's weight equal to the percentage of total multichannel subscribers that received the network. The sum of the license fees for those networks identified as being carried because of retransmission consent in 2004 was $3.67. In 1997, the license fees for these

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[22] Rogerson, p. 18. Another study done by Cap Analysis reported that increased programming costs accounted for only 22 percent of the increase in expenditures by cable operators between 1999 and 2002. CapAnalysis, Rising Cable TV Rates: Are programming Costs the Villian?, October 23, 2003, p. 12.

[23] GAO, *Issues Related to Competition and Subscriber Rates in the Cable Television Industry,* October 2003 ("GAO Report"), pp. 25-26.

[24] Rogerson, Table 9.

[25] Kagan does not list any information for Fuel or Shop NBC.

networks totaled $1.11. Note that about half of these networks did not exist in 1997. The increase in license fees for these networks from 1997 to 2004 was $2.56. By comparison, the increase in cable rates during the same period was $14.98.[26] In other words, the increase in the average license fee paid per subscriber attributable to these 25 networks was only 17 percent of the increase in cable rates. The increase due to the nine listed Viacom-owned networks is only $0.18. Even accepting the ACA's list, license fees of networks carried because of retransmission consent cannot be fairly described as a major factor driving the increase in cable rates. Moreover, if cable operators were not carrying the broadcast-affiliated cable networks that commenters blame for recent cable rate increases, the operators would be carrying, and paying license fees for, other program services.

Commenters' third claim is that the four major broadcast networks use retransmission consent in order to obtain carriage of affiliated cable channels at higher rates and on more favorable terms than would otherwise have been the case.[27] While the commenters provide no support for this statement, a recent GAO study did examine these issues. To quote GAO's findings:

> Some concerns exist that ownership affiliations might indirectly influence cable rates. Broadcasters and cable operators own many cable networks. GAO found that cable networks affiliated with these companies are more likely to be carried by cable operators than nonaffiliated networks. However, cable networks affiliated with broadcasters or cable operators do not receive higher license fees, which are payments from cable operators, than nonaffiliated networks.[28]

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[26] Report on Cable Industry Prices, Attachment 4.

[27] JCC, p. 11.

[28] GAO Report, Highlights of GAO-04-8.

Hence, contrary to commenters' allegations, GAO found "that ownership affiliations—with broadcasters or with cable operators—had no influence on cable networks' license fees."[29]

IV. Effects of Retransmission Consent on Broadcast Programming

Economic theory predicts that granting television stations the opportunity to be compensated for retransmission consent should increase the incentives to provide attractive programming. Stations' choices about the type and quality of programming to carry (including the network affiliation decision) are made to maximize their profits. Stations derive the majority of their revenues from the sale of advertising. Compensation for retransmission consent gives stations an additional way to contribute to their profits. As with advertising revenue, the stations' benefits from retransmission consent will tend to increase with the appeal of its programming, holding other factors constant. Retransmission consent thus increases the total return that a station can expect from its programming, and tends to increase the expenditure level on programming that the station will choose.

The increased incentives for quality programming can be manifest in improved quality of the local programming that stations produce, as well as the syndicated programming that they acquire. Networks providing programming to their affiliated stations can also respond to the change in stations' incentives and provide higher quality programming. Networks also have a direct incentive to do so through the effect that improved network programming has on the compensation that their owned and operated stations receive for retransmission consent.

Professor Rogerson concludes there is no convincing evidence that the quality of network programming has improved as a result of retransmission consent. One response is to note that, to the extent that the effect of retransmission consent is manifest in the quality of

[29] GAO Report, p. 29.

local and syndicated programming, his attempt to measure network programming quality misses the mark. A second response is that several of his measures of network programming quality are flawed or misleading.

Professor Rogerson believes that there is a relationship between revenues and programming expenditures. He argues that since the broadcast networks can command higher advertising rates than cable networks, broadcast networks will be better able to acquire programming.[30] It seems odd to believe that broadcast networks' increased advertising revenue would improve their ability to acquire programming but that revenue gains through retransmission consent would not.

Professor Rogerson's Table 11 compares the growth in programming expenditures by broadcast networks and cable networks. While he points out that the overall share of programming expenditures devoted to broadcast programming has been falling, he fails to control for the fact that the number of national video programming services more than tripled during the time period he examines.[31]

Additionally, Professor Rogerson's analysis does not consider any increases in local station programming expenditures. The vast majority of broadcast television stations are not owned by one of the four major networks, so any retransmission consent payments or compensation made to those television stations would be expected to have the most direct effect on local and syndicated programming expenditures, not network programming expenditures.

Professor Rogerson argues that the quality of broadcast programming has not increased since retransmission consent was enacted. He bases his conclusion on two analyses. In his first analysis, presented in Table 12, he shows that "unscripted" programming hours have increased and that movie hours have decreased on the four major broadcast

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[30] Rogerson, p. 31.

[31] NCTA, *Cable Television Developments 2004*, p. 19, and Eleventh Annual Report, ¶ 15.

networks during prime time from 1992 to 2004. Of course, movies are widely available through other programming sources and rentals, so they haven't disappeared. Professor Rogerson apparently is making a value judgment, on behalf of himself and Congress, that movies are higher quality programming than "unscripted" programming. Over the same time period there was also an increase in the number of prime time newsmagazine hours. Professor Rogerson does not indicate whether he views this as an increase or decrease in quality.

Professor Rogerson's second analysis of broadcast programming quality is presented in Table 13, where he reports the number of prime time Emmys won by the broadcast networks and cable networks for various years from 1992 to 2003. Since the number of Emmys going to broadcast networks has fallen relative to the number going to cable networks, he concludes that the quality of broadcast programming has not increased. Professor Rogerson seems to be ignoring the possibility that while the programming quality of the broadcast networks increased so has the quality of the cable networks, especially the premium cable networks.

Appendix A

Concentration and Viacom Share of Non-Broadcast Programming

On January 28, 2004, the Commission released its Tenth Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming.[32] In that report, the Commission indicated that it had identified 339 satellite-delivered national programming networks. (¶¶ 141-2). Tables C-1 and C-2 in that report provide information on 266 national networks. In early 2004, Economists Incorporated undertook an analysis of the ownership of these 266 networks. The Commission's Tables C-1 and C-2 supply a launch date for each of these networks and complete or partial ownership information for many networks. Information from public sources including books, websites and trade press articles was used to fill out missing ownership information and add subscriber levels to the extent possible.[33]

Concentration of non-broadcast network ownership and Viacom's share of non-broadcast networks were measured in three ways: (1) weighting networks equally; (2) weighting each network by its number of subscribers; and (3) weighting each network by its revenue.

Weighting networks equally

In this analysis, each network was counted equally with every other network, and no distinction was made based on the popularity or value of a network. This approach makes use of information for all 266 national networks listed in the Tenth Annual Report. Each network was attributed to a single owner. Most often the attributed owner had a majority

[32] Tenth Annual Report, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, MB Docket No. 03-127, Released: January 28, 2004.

[33] With the large number of networks, the need to rely on public sources, and changes in ownership, it is difficult to guarantee 100 percent accuracy. We are unaware of any inaccuracies, but if there are any we believe they would not materially change the statistical conclusions presented here.

ownership in the network. In some cases, one owner was chosen from two owners with 50 percent shares. In such cases, ownership was attributed to the owner with the larger number of other networks.[34] Networks for which no ownership information could be determined, and networks with no owner above 49 percent, were assumed to be owned independently. Under these assumptions, the HHI based on the number of networks attributed to various owners was 467.[35] Viacom is the attributed owner for 36 of the 266 national networks, giving it a share of about 14 percent.

Weighting networks by subscribers

This analysis weights each network by its number of subscribers. Subscriber information could be found for only 205 of the 266 networks, and the analysis is limited to those 205. As in the preceding analysis, each network was attributed to a single owner. The resulting HHI is 730, and Viacom's share of subscribers among this group of networks is 17 percent.

Weighting networks by revenue

The third analysis is based on weighting each network by its revenues. Paul Kagan Associates has estimated 2003 revenue information for nine owners of non-broadcast basic network programming.[36] According to Kagan's estimates, these nine owners account for approximately 85 percent of total revenues of non-broadcast basic networks.[37] Computing shares based on revenues results in an HHI of 1,195.[38] Viacom's share of basic cable network revenue was measured at 17 percent.

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[34] The effect of this is to tilt the calculation towards showing higher concentration.

[35] The Herfindahl-Hirschman Index (HHI) is calculated as the sum of the squares of the shares of individual participants. The HHI can range between 10,000 and a number near zero.

[36] "The New Basic Cable Network Landscape--Basic Cable Attributable Revenue by Owner," Cable Program Investor (CPI) No. 70-3, September 12, 2003.

[37] Total estimated 2003 revenue from "Cable Network Buyers Pensive? Basic Cable Networks Economics Snapshot; Broadcast vs. Cable National Ad Revenue; Basic Cable Network Economics, 1983-2013," Cable

The HHI levels under these three measures range from a low of 467 to a high of 1,195. For two of the measures the HHI is below 1,000, a level considered unconcentrated. The highest of these measures puts concentration in what the Department of Justice and Federal Trade Commission consider to be the "moderately concentrated" range. Under these three measures, Viacom's share ranges from 14 to 17 percent, a range that is well below levels associated with anticompetitive market power.

Program Investor (CPI) No. 70-6, September 12, 2003. In Kagan's estimates, revenue was assigned to owners according to their share of the networks involved, rather than assigning all revenue to a single majority owner.

[38] In the absence of revenue shares for owners outside the nine estimated by Kagan, the HHI calculation assumed that the remaining revenue was owned by firms each having 1 percent of revenue.